



COUNCIL AGENDA: 02-14-12
ITEM: 3.7

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Dennis Hawkins, CMC
City Clerk

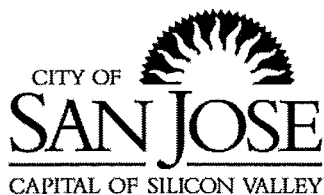
SUBJECT: SEE BELOW

DATE: 2-1-12

**SUBJECT: AUDIT OF TEAM SAN JOSÉ AND CONVENTION AND VISITORS
BUREAU PERFORMANCE 2010-11**

RECOMMENDATION

As recommended by the Public Safety, Finance and Strategic Support Committee on January 26, 2012 and outlined in the attached memo previous submitted to the Public Safety, Finance and Strategic Support Committee, accept the City's Auditor's Report on Team San José and Convention and Visitors Bureau Performance for 2010-11.



Office of the City Auditor

**Report to the City Council
City of San José**

**2010-11 ANNUAL
PERFORMANCE AUDIT OF
TEAM SAN JOSE'S
MANAGEMENT OF THE
CITY'S CONVENTION AND
CULTURAL FACILITIES**

**Report 12-03
January 2012**

January 18, 2012

Honorable Mayor and Members
Of the City Council
200 East Santa Clara Street
San José, CA 95113

2010-11 Annual Performance Audit of Team San Jose's Management of the City's Convention and Cultural Facilities

Since 2004, the San José McEnery Convention Center and several other facilities have been operated on the City's behalf by Team San Jose, Inc. (TSJ). Under the terms of the Management Agreement between TSJ and the City, the City Auditor annually audits TSJ's management of the facilities with a focus on whether TSJ achieved their agreed-upon performance goals. For the FY 2010-11 performance audit, we have also included a review of TSJ's convention and visitors bureau (CVB) efforts.

After Significant Cost Cutting, Team San Jose's Operations of City Facilities Resulted in Improved Financial Results in FY 2010-11. TSJ increased its operating revenue in 2010-11 to \$18.8 million and cut operating expenditures by nearly \$3.7 million, reducing its operating loss to \$2.4 million (as calculated in conformance with the Management Agreement) – compared to a \$6.9 million loss in 2009-10. As a result, TSJ met its 2010-11 target for gross operating loss.

The gross operating loss that we calculated (\$2.4 million) is different than the \$1.8 million operating loss that TSJ initially reported due to conflicting provisions in the management agreement. To ensure consistency from year to year in how the TSJ computes its gross operating profit, we recommend that the City and TSJ clarify the Management Agreement.

Team San Jose Met 7 of its 9 Performance Targets for FY 2010-11. The 2009 Management Agreement requires Team San Jose to report annual performance measures compared to established targets. In addition to meeting its targets for gross operating revenue and gross operating profit, TSJ met all 4 of its performance measures in the area of economic impact – event attendance, hotel-nights, estimated economic impact and return on investment. In FY 2010-11, TSJ drew nearly 1 million people to events at the Facilities; resulting in more than 200,000 hotel night bookings. In the category of theater performance (performance days and occupied days), TSJ fell short of its FY 2010-11 performance targets, while it met its performance target for customer satisfaction. Overall, TSJ achieved a performance score that earned them the maximum incentive fee of \$350,000.

CVB Operates Under a Separate Agreement with the City of San José. The CVB has the mission of enhancing the image and economic well-being of San José as a globally-recognized destination. The CVB provides a comprehensive sales and marketing program to advertise and promote the City to achieve as the City's first priority the goal of booking conventions, trade shows, conferences, and other events at the Convention Center and area hotels, especially events that will bring out of town visitors to San José, who end up staying in San José hotels.

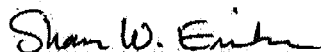
In 2010-11, TSJ received a total of \$3.8 million in revenue from the City to support CVB activities including sales, marketing, and public affairs. Although it operates under a separate Management Agreement with the City, CVB's performance goals are clearly aligned with TSJ's overall performance goals. For example, the sales team generates sales leads for convention center business, and attends trade shows around the country, as well conducts familiarization tours for meeting planners interested in holding a convention or meetings at our convention center or a San José hotel. Since the primary efforts of the CVB are geared toward achieving the goal of booking conventions, trade shows, conferences, and other events at the Convention Center and area hotels, we see no reason to continue keeping certain aspects of the CVB's operation separate from that of the operation of the convention and cultural facilities and we recommend that the management agreements be consolidated into one agreement when both agreements expire in 2014.

One of the strategies that the CVB uses to promote hotel stays in San José is to provide subsidies to groups who commit to hold their major events in San José. This appears to be a common practice for convention and visitor bureaus around the country. In the future, to ensure that Team San Jose receives proper credit for the economic impact that its activities generate for the City and its hotels, the City and Team San Jose should evaluate how other CVBs across the country incorporate the value of subsidies in their calculation of economic impact.

Finally, to ensure that TSJ is adhering to its own travel and entertainment policy, we reviewed a sales manager's travel expense claim and an invoice that covered airline expenses in FY 2010-11. The charges were well documented and properly approved by a supervisor and we did not identify any instances in which TSJ did not adhere to its travel policy.

I will present this report at the January 26, 2012 meeting of the Public Safety, Finance, and Strategic Support Committee. We would like to thank the management and staff of Team San Jose, Inc., the Finance Department, the Office of Economic Development, the City Attorney's Office, and the City Manager's Budget Office for their time, information, insight, and cooperation during the audit process. Team San Jose and the City Administration's response are shown in the yellow pages attached to this report.

Respectfully submitted,



Sharon W. Erickson
City Auditor

finaltr
SE:lg

Audit Team: Steve Hendrickson
Carolyn Huynh

cc: Bill Sherry Lee Wilcox
Ed Shikada Eric Bilimoria
Debra Figone Belinda Silvatici
Julia Cooper Dave Costain
Jennifer Maguire Janette Sutton
Brian Doyle Diana Ponton

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Introduction

In accordance with the City Auditor's fiscal year (FY) 2011-12 Audit Work Plan, we have completed an audit of Team San Jose, Inc.'s (TSJ) management of the City's convention and cultural facilities to determine whether TSJ met the performance measures specified in the Agreement for the Management of the San José Convention and Center and Cultural Facilities between the City of San José and Team San Jose, Inc. (Management Agreement) for FY 2010-11. In accordance with our FY 2011-12 Audit Work Plan, we also assessed the costs and services of TSJ's Convention and Visitor Bureau (CVB) efforts.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis on our audit objectives. We limited our work to those areas specified in the Objective, Scope, and Methodology section of this audit report.

The City Auditor's Office would like to thank the management and staff of Team San Jose, Inc., the Finance Department, the Office of Economic Development, the City Attorney's Office, and the City Manager's Budget Office for their time, information, insight, and cooperation during the audit process.

Background

The San José Convention and Cultural Facilities (the Facilities) consists of the San José McEnery Convention Center, San José Civic, Parkside Hall, South Hall, Center for the Performing Arts, California Theater, and Montgomery Theater. These seven venues offer trade show exhibits, conventions, corporate meetings, social events, consumer shows, and performing arts.

Team San José, Inc., a non-profit corporation, formed in December 2003 in response to the City's request for proposals for the management and operations of the Convention Center, which was formerly managed by the City's Department of Convention, Arts, and Entertainment. The City entered into a Management Agreement with Team San José to operate and manage the Facilities. The original term of the Agreement was for the five-year period from July 1, 2004 through June 30, 2009. On August 13, 2009, the City exercised its option to extend the original term for one additional five-year period through June 30, 2014. TSJ has a 15-member board of directors (recently changed from 28 members). Its board includes representatives from local hotels, arts, business, and labor. Included in its board are a City Council liaison and an ex-officio member from the City Manager's office.

TSJ's management agreement requires the City Auditor's Office to conduct an annual audit of the performance measures in the agreement. For the FY 2010-11 performance audit, we have included a review of TSJ's convention and visitors bureau, in addition to their management of the convention center and cultural facilities.

Recent Key Events

In May 2010, the Civil Grand Jury presented its report: "Should the City Council Continue to Subsidize Team San José's Increasing Losses?"

In August 2010, the City issued TSJ a notice of default because TSJ's FY 2009-10 expenditures exceeded its operating budget by more than \$750,000, which is in violation of the terms of the Management Agreement.¹ This resulted in a number of actions including an expanded performance audit by the City Auditor, and Council later directed to the City Manager to begin development of an RFP for management of the convention center and cultural facilities and services provided under the Convention and Visitors Bureau.

In March 2011, the Council adopted a second amendment to the TSJ Management Agreement and the City's Convention and Cultural Affairs Fund (Fund 536) which reflected recommendations from the City Auditor's FY 2009-10 Annual Performance Audit. And in December 2011, the City Council voted to discontinue work on the Request for Proposal for the management of the Convention Center and Cultural Facilities.

Convention Center Expansion

The San José Convention Center is currently undergoing renovation and expansion. The expansion will add an additional 125,000 square feet of flexible ballroom and meeting room space, increasing San José's convention center space to 550,000 square feet of usable space. The 125,000 total square feet of new, flexible space includes:

- 25,000 square feet of flexible meeting space
- 35,000 square feet of flexible ballroom space
- Renovation and integration with the existing structure
- The new construction is a new footprint that expands the square footage with minimal impact to the current convention center.

The San José Convention Center will be open during construction and will celebrate a grand re-opening in late summer or early fall 2013. In May 2011, TSJ began booking events into the new expansion space.

¹ As of June 30, 2011, Team San Jose is no longer in default.

Team San Jose, Inc. and Convention and Visitors Bureau Merger

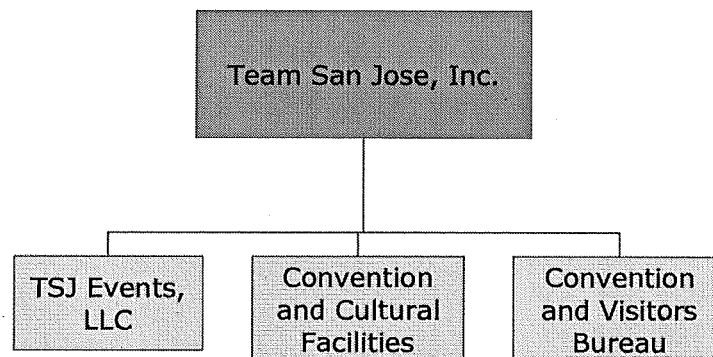
The San José Convention and Visitors Bureau (CVB) was established as a nonprofit, 501(c)6 organization in 1984. The City entered into an agreement with the CVB in June, 2000 for the period July 1, 2000 to June 30 2005, with one additional five year option which was exercised extending the Agreement from July 1, 2005 to June 30, 2010. The contract has since had five amendments with the most recent amendment extending the agreement to December 31, 2011. In December 2011, the City Council directed the City Manager to negotiate a new CVB Agreement with TSJ for the period of January 1, 2012 to June 30, 2014, with two additional three-year options.

On February 1, 2009, Team San Jose, Inc. and the San José Convention & Visitors Bureau merged and now operate under the name Team San Jose, Inc. Currently, TSJ has two agreements with the City, one to operate and maintain the City's convention and cultural facilities and the other, the CVB agreement, to promote San José as a destination for meetings, conventions, trade shows and other pleasure travel. The term for both contracts ends on June 30, 2014.

Team San Jose Business Structure

As mentioned above, Team San Jose operates and maintains the City's convention and cultural facilities. Its other main role is conducting sales and marketing activities to promote San José, California as a site for meetings, conventions, trade shows, as a destination for pleasure travel. We describe TSJ's overall business structure below. However, for this report, we focus our review on TSJ's performance in operation and maintenance of the convention center and cultural facilities and its sales and marketing activities.

Exhibit I: Team San Jose Business Structure



Source: Team San Jose

Team San Jose – Is a unique partnership of TSJ staff, the San José Convention and Visitors Bureau (CVB), City employees, and other contracted employees that manages and operates the convention and cultural facilities and promotes San José as a travel destination.

Convention and Cultural Facilities (Facilities) – A division of Team San Jose, operating under the City contract. Expenses are generally related to events, facility operations and facility usage.

Convention and Visitors Bureau (CVB) – A division of Team San Jose, operating under City contract. Expenses are primarily related to visitor services and marketing of San José and Management Team expenses. These are often expenses related to Public Relations, Sales & Marketing, Visitor Services, etc. The mission of the CVB is to enhance the image and economic well being of the City by taking the leadership role in marketing the City as a globally recognized destination. The CVB provides marketing, promotion, and sales support services for the convention center and cultural facilities, and provides full service destination planning to meeting planners, tour operators, and individual visitors. Under an agreement with the City of San José, certain expenditures made by the CVB in connection with its activities are reimbursed by the City of San José.

TSJ Events, LLC (TSE) – On March 19, 2009, Team San José established TSJ Events, LLC to provide food and beverages at events catered by the Facilities. Team San José is the only member of TSJ Events, LLC, and, as such, has a controlling interest in the operations of the entity. Per the Operating Agreement between Team San José and TSJ Events, LLC, all revenues and expenses from activities performed by TSJ Events, LLC will be allocated to Team San José. Alcohol-related revenue, expenses, and balance sheet activities are recorded in this LLC.

Other Non-Profit Partners

Team San Jose also has contracts with other non-profit organizations to provide services that include San José Hotels, Inc., a non-profit organization that administers the City's Hotel Business Improvement District Fund, which is made up of fees levied on hotel guests to support effort to increase occupancy rates in City Hotels. TSJ received an additional \$24,000 for services it provided to San José Hotels, Inc. According to TSJ, spending decisions are made by the San José Hotels, Inc. Board of Directors, who are representatives from the hotel industry, based on suggestions from TSJ staff.

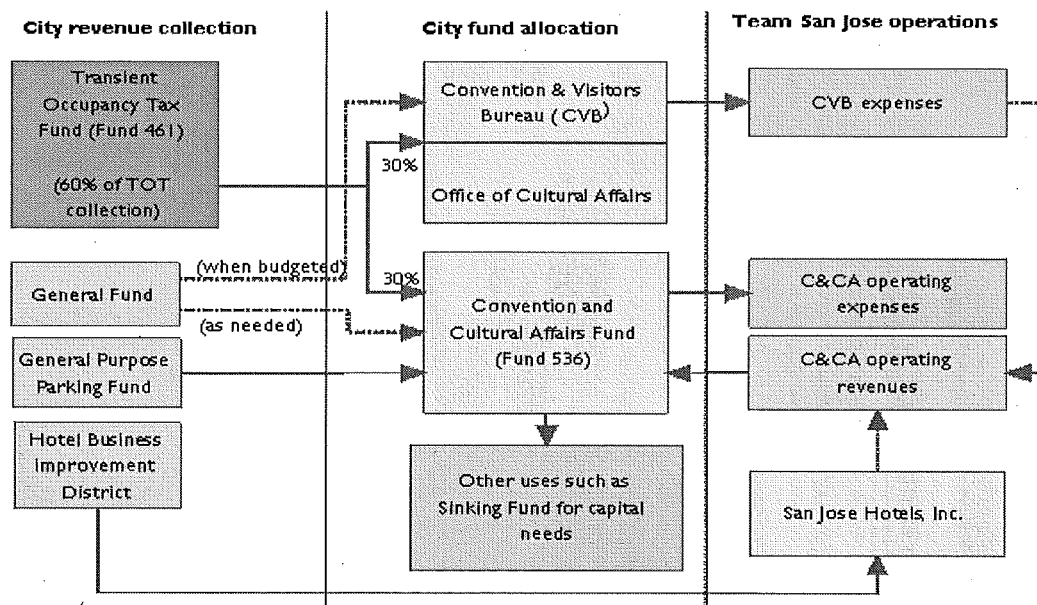
TSJ also has a contract with San José Theater Preservation -- an organization that works to preserve the San José Center for the Performing Arts, San José Civic, Montgomery Theater, and the California Theater. San José Theater Preservation, Inc. is controlled by local arts organizations. Team San Jose provides the service of collecting their revenue and provides building capital needs analyses. As of

February 2011, Team San Jose is no longer on the Board of Directors for San José Theater Preservation and no longer provides administrative services, other than revenue collection.

Flow of Funds

The Facilities, under the management of TSJ, generate revenues which help fund the operations. However, to continue its operations, TSJ relies on City operating contributions from the Transient Occupancy Tax Fund (TOT). In addition, the General Purpose Parking Fund transferred some revenue from the Convention Center parking facilities², and, in some years, the General Fund has transferred revenue and/or reimbursements. Currently, approximately 30 percent of TOT collections are transferred to the Convention and Cultural Affairs Fund (Fund 536) and approximately 30 percent are split between CVB and the Office of Cultural Affairs.³ The remaining 40 percent of TOT collections go to the City's General Fund. As noted by the external auditors, "... any significant changes in the TOT or parking garage revenues or a decision to change the amount of support could greatly affect the Center's ability to continue as a going concern."

Exhibit 2: Flow of Funds to and from the Convention and Cultural Affairs Fund⁴



Source: Interviews with the Finance Department and TSJ staff, and review of San José Municipal Code and the Civil Grant Jury Report issued May 2010.

² There are no projected transfers from the General Purpose Parking Fund to Fund 536 in FY 2011-12. For more detail, see page 22.

³ The CVB also occupies office space in the San Jose Convention Center at no cost and shares financial and human resources staff with Team San Jose.

⁴ San Jose Hotels, Inc is a separate non-profit organization controlled by local San José hotels. Team San Jose is contracted with Hotel Business Improvement District (HBID) to provide services. This organization has an annual vote/renewal. Hotels leverage resources by partnering with the CVB team to execute initiatives that are of mutual benefit to the City of San José.

Communications Working Group

The Communications Working Group (CWG) was created through City Council adoption of the Mayor's March 2009 Budget Message in order to improve coordination between the various departments and outside groups who receive City and Redevelopment Agency funding to market the City of San José. For more information see: <http://www.sanjoseca.gov/mayor/CWG/background.asp>.

In his March 2009 Budget Message, Mayor Reed gave the following direction which led to the formation of the CWG:

In these tough times, San José must spend its existing marketing resources more efficiently. Over the next year, I recommend that the City Manager and Redevelopment Agency Executive Director continue to work in partnership with the Mayor's Public Information Officer to bring these disparate efforts together and coordinate marketing activities. This effort will measure the return on our investments, and pursue opportunities and new ideas to spur new investment and grow San José's identity as an innovator in emerging technologies, create vibrancy Downtown, encourage retail spending, and bring new business to the Airport. This effort should include regular reports to the Community and Economic Development Committee.

Since then, the CWG has worked collaboratively to address common marketing challenges and coordinate efforts to best position San José during these tough economic times, to do peer-review marketing plans/budgets, and develop performance measures,

The CWG is chaired by the Mayor's Public Information Office and currently includes representatives from the City Manager's Office, the Airport, the Office of Economic Development, the San José Silicon Valley Chamber of Commerce, the San José Downtown Association, and Team San Jose. Since the downsizing of the Redevelopment Agency last year, the Agency no longer has a member represented at these meetings. According to the Mayor's Office, the CWG was established with a mechanism to vote, however it has not been enforced. The groups have instead been focused on peer-reviewing each other's efforts and providing a venue for discussion and collaboration.

Industry Advisor

In August 2010, the City issued a Notice of Default to TSJ under the terms of their Management Agreement with the City, and the Council later directed the City Manager to begin development of an RFP for management of the Convention Center and cultural facilities and services provided under the Convention and

Visitors Bureau. In addition, the City Manager recommended hiring a hospitality industry advisor to help develop an RFP and to provide ongoing support to the City regarding the convention center and tradeshow industry.

Benchmarking Study

The Management Agreement provides for a benchmarking study in year two (FY 2010-11) and year four (FY 2013-14) of the Agreement. According to the Management Agreement,

During the second and fourth years of the Initial Term, in coordination with City, will cause to be conducted a report (the benchmark survey) comparing the convention center operations to at least five of the Designated Convention Centers based on a set of comparison metrics to be mutually agreed to by City and Operator.

The City enlisted Conventions, Sports & Leisure, International (CSL) to assist in the development of an RFP, best-practices report of Convention Center Industry Oversight Structure Models, TSJ Benchmarking Study and ongoing support for the City. The Office of Economic Department's Downtown Manager is the project manager for this contract.

CSL presented, "Summary of Convention Center Industry Oversight Structure Models" to the City on June 2, 2011. It is a report detailing organizational structures used for convention center and destination marketing organizations, both as separate and combined structures. The report presents case studies for selected markets focusing on the methods, structures, and policies in place for management of convention center assets and destination marketing organizations.

Based on CSL's review of conditions in San José, as well as national trends and conditions, CSL made the following observations:

- The structural changes in San José are reflective of national trends that seek to better align the strategic goals and objectives.
- Several markets nationally have looked to the changes in San José to inform their approach to aligning facility and destination marketing operations.
- The Team San Jose concept appears to have created a greater sense of coordination between convention center and destination marketing organization priorities (i.e. one-stop shop concept for event planners).
- The current Team San Jose leadership appears to have addressed many of the concerns expressed about the past structural changes.

- The inclusion of a diverse set of facilities (convention center, performing arts and civic venues) into the Team San Jose structure can create unique challenges and opportunities.

CSL is currently preparing the convention center industry benchmarking report which will outline the approach to convention center management undertaken at seven to ten destinations nationally. CSL's will present a summary of the methods, structures and policies in place for each of the case studies, as well as a description of the strengths and weaknesses of each approach. CSL will also research linkages between convention center management models and the ability to expand services to other facilities. This report is expected to be released in early 2012.

Current TSJ Performance and Incentive Measures

In June 2009, the City and TSJ entered into an addendum to the Management Agreement, clarifying performance measures and incentive pay. Because construction of the facilities managed by TSJ was financed through tax-exempt debt, the management contract cannot, according to the City Attorney's Office, have an incentive pay provision that is based on return on investment or gross operating profits; hence, the incentive measures used to determine TSJ's incentive pay differ slightly from the general performance measures. The 2009 Management Agreement requires TSJ to submit annual targets for the following performance and incentive measures for City review, and joint agreement. Exhibit 3 shows how these measures are to be weighted.

Exhibit 3: Performance and Incentive Measure Weighting

Performance Measure		Incentive Measure	
Economic Impact	40%	Economic Impact	40%
Hotel Room Nights (10%)		Hotel Room Nights (15%)	
Attendance (10%)		Attendance (10%)	
Estimated Economic Impact (10%)		Estimated Economic Impact (15%)	
Return on Investment (10%)			
Gross Operating Profit	40%	Gross Operating Revenues	40%
Theater Performance	10%	Theater Performance	10%
Customer Service Survey Results	10%	Customer Service Survey Results	10%
TOTAL	100%	TOTAL	100%

Source: Second Amendment to the Management Agreement

The 2009 Management Agreement also requires TSJ to submit information on the following special reporting metrics: Theater Operations, Benchmark Convention Business, and Impressions, Marketing/Branding.

Objectives, Scope, and Methodology

The objective of our audit was to determine whether TSJ met its performance measures as specified in the Management Agreement for FY 2010-11. Also, we reviewed significant variances to FY 2009-10 revenue and expense information. We also followed up on results to changes in TSJ's business model as well as outstanding audit recommendations.

To determine whether TSJ met its performance measures for economic impact, gross operating profit/revenues, return on investment, theater performance, and customer service results, we:

- Reviewed the Management Agreement, its Addendum and Amendments for descriptions of performance and incentive measures, and the Council-adopted targets for FY 2010-11;
- Obtained and reviewed the audited financial statement for the Facilities for FY 2010-11;
- Interviewed the external auditor for the Facilities, staff from Macias, Gini, and O'Connell, LLP (MGO), and the staff from the City's Finance Department, Budget Office, and Office of Economic Development;
- Obtained the audits of Petrinovich & Pugh addressing the validity of the number of hotel-nights booked by Team San Jose;
- Validated the Team San Jose's computation of two key performance measures - Gross Revenue and Gross Operating Profit;
- For a sample of theater events, we verified that Team San Jose had properly recorded the figures for days that the theater has been occupied and days on which performances actually occurred;
- Interviewed senior members and staff of TSJ;
- Tested the accuracy of attendance reporting data for FY 2010-11;
- Obtained and reviewed TSJ's customer service surveys for FY 2010-11; and
- Reviewed TSJ's FY 2010-11 monthly and annual reports.

To identify the cause for significant variance in TSJ's financial results from FY 2009-10 to FY 2010-11, we interviewed TSJ finance and accounting staff and obtained detailed breakdown of TSJ performance by line of business.

To assess the costs and services of Team San Jose's convention and visitor services, we:

- Reviewed the current Agreement between City and Convention and Visitors Bureau;
- Determined TSJ's compliance with its contract requirement, including its fund allocation use;
- Reviewed TSJ's marketing plan and associated performance metrics. We assessed TSJ's level of tracking of these performance metrics;
- We reviewed last three years of TSJ's (dba Convention and Visitors Bureau) financial statements;
- Reviewed reports by the Industry Advisor contracted by the City to provide benchmarking and convention industry trend information;
- Obtained and reviewed travel, entertainment, and commission policies;
- We reviewed two FY 2010-11 Team San Jose travel and entertainment expenditures; and
- We tracked several FY 2010-11 sales and marketing expenditures through Team San Jose's accounting records.

Finding I After Significant Cost Cutting, Team San Jose's Operations of City Facilities Resulted in Improved Financial Results in FY 2010-11

Summary

TSJ increased its operating revenue in 2010-11 to \$18.8 million, an increase over 2009-10. And, due to a nearly \$3.7 million reduction in operating expenditures, TSJ reduced its operating loss from the prior year of \$6.9 million to \$2.4 million. This is different than the \$1.8 million operating loss that TSJ reported due to the different calculation of the fixed management and incentive fees. The differing calculations do not change the fact that TSJ met its 2010-11 target for gross operating loss. Under either scenario, TSJ met the performance target.

TSJ's improved operating results can be attributed in part to a \$2 million increase in food and beverage revenue over the prior fiscal year, offset by a modest decline in building rental revenue over FY 2009-10. TSJ's operating results were further enhanced by a \$2.8 million reduction in operating expenses over the previous year largely because of a decrease in labor cost related to employing 42 fewer City-shared employees. Additional cost-saving measures were implemented during the year:

- TSJ reduced overall personnel expenditures;
- Union contracts were renegotiated to freeze increases for FY 2010-11; and
- Cost controls and standard operating procedures were implemented.

TSJ's operating loss has been subsidized by Transit Occupancy Tax, City transfers from the General Fund in some years, and fund balance in the City's Convention and Cultural Affairs operating fund (Fund 536).

Gross Operating Revenues Have Increased, While Net Operating Losses (as Calculated in Conformance to the Management Agreement) Have Decreased

As shown in Exhibit 4 below, gross revenues for FY 2010-11 were over two and a half times what they were in FY 2004-05 (the first year that TSJ operated the Facilities) -- growing from \$7.2 million to \$18.8 million. This marks the highest gross operating revenue ever earned by TSJ. As we reported last year, TSJ

2010-11 Annual Performance Audit of Team San Jose

experienced its highest net operating loss of \$6.9 million in FY 2009-10. However, in FY 2010-11, TSJ has dramatically decreased its net loss (by our calculation) to about \$2.4 million as shown below.

Exhibit 4: Operating Profit and Loss for the Facilities from FY 2004-05 to FY 2010-11 as Calculated in Accordance with the Management Agreement⁵

	Year One 2004-05	Year Two 2005-06	Year Three 2006-07	Year Four 2007-08	Year Five 2008-09	Year Six 2009-10	Year Seven 2010-11	% Variance from 2009-10 to 2010-11
Operating Revenues								
Food and beverage services	\$1,209,721	\$2,048,213	\$2,521,900	\$ 2,760,809	\$ 2,008,242	\$ 6,461,076	\$ 8,442,324	30.7%
Building rental	4,194,140	4,489,668	5,078,075	5,855,214	5,281,338	4,548,200	4,264,884	-6.2%
Labor/Event Production Labor Revenues	14,669	40,138	59,070	474,399	2,331,468	3,497,422	3,459,464	-1.1%
Ticketing Services					123,865	1,485,611	547,072	-63.2%
Heat and power services charges	551,427	520,262	771,870	794,488	580,649	536,231	440,286	-17.9%
Event electrical/ utility services	460,927	619,297	737,676	834,180	695,084	504,287	694,658	37.8%
Audio/visual services	266,438	298,588	431,674	475,843	446,967	394,437	474,735	20.4%
Other revenues	59,772	140,084	294,046	184,369	364,404	277,410	149,971	-45.9%
Networking services	245,000	481,584	482,964	450,086	380,334	215,807	277,778	28.7%
Equipment rentals	56,988	46,262	59,977	65,773	58,159	62,551	69,279	10.8%
Telecommunications services	99,731	90,226	117,310	118,295	80,465	56,417	26,880	-52.4%
CV8 Rent Subsidy*							-20,073	
HBID Admin. Revenue*							-24,000	
Total Operating Revenues	\$7,158,813	\$8,774,322	\$10,554,561	\$12,013,456	\$12,350,975	\$18,039,449	\$18,803,258	
Operating Expenses								
Team San Jose employee salaries	\$645,366	\$872,271	\$1,237,668	\$1,972,234	\$1,923,319	6,107,273	7,706,500	26.2%
City shared employee charges	6,228,160	5,820,023	6,645,397	6,754,513	6,662,719	5,023,569	2,183,614	-56.5%
Cost of event production labor					1,967,629	2,973,411	3,092,689	4.0%
Utilities	2,335,139	2,467,647	2,535,946	2,595,186	2,561,984	2,425,746	2,450,423	1.0%
Ticketing Costs						1,344,386	183,633	-86.3%

⁵ The audited financial statements for the convention and cultural facilities showed a net loss of \$4.1 million. The loss numbers presented in this exhibit are in conformance with the Management Agreement and do not include all costs that the City incurs to operate the Facilities. Specifically, we do not include TSJ's fixed management fee, depreciation expense, City contract oversight costs, fire insurance, City-funded repairs and maintenance, or the City's free use of the Convention Center.

	Year One 2004-05	Year Two 2005-06	Year Three 2006-07	Year Four 2007-08	Year Five 2008-09	Year Six 2009-10	Year Seven 2010-11	% Variance from 2009-10 to 2010-11
Food & Beverage Costs						1,305,813	1,380,091	5.7%
Other expenses	317,857	668,446	763,447	869,202	645,780	1,067,439	1,018,558	-4.6%
Overhead - City of San José	542,368	555,116	865,262	911,940	883,727	808,813	248,686	-69.3%
Contracted outside services	516,980	714,818	461,066	421,067	535,234	622,234	338,592	-45.6%
Professional Services					509,676	594,281	488,185	-17.9%
Operating supplies	302,600	410,711	420,768	455,786	469,809	453,497	372,657	-17.8%
Bad debt expense					567,751	423,457	72,342	-82.9%
Repairs and maintenance	231,123	392,837	394,565	375,380	299,702	412,585	421,080	2.1%
Team San Jose Management Fee	150,000	150,000	150,000	150,000	150,000		150,000	100.0%
Team San Jose Management Incentive Fee (new contract)						400,000	350,000**	-12.5%
Workers' compensation insurance premiums	124,820	226,559	130,268	175,612	219,996	357,269	237,651	-33.5%
Equipment Rentals					117,100	318,934	200,919	-37.0%
Insurance	276,064	280,854	282,330	287,093	257,948	284,834	285,792	0.3%
Contracted services - City of San José	117,403	83,939						
Total Operating Expenses	\$11,787,880	\$12,643,221	\$13,886,718	\$14,968,013	\$17,772,374	\$24,923,541	\$ 21,181,412	-15.0%
Gross Operating Loss	-\$4,629,067	-\$3,868,899	-\$3,332,156	-\$2,954,557	-\$5,421,399	-\$6,884,092	-\$2,378,154	-65.5%
Team San Jose Executive Management Fee (new contract)						663,324	600,000	-9.5%

Source: Auditor analysis of audited financial statements for the San José Convention and Cultural Affairs Fund.

*CVB Rent Subsidy and HBID revenues are deducted from total gross operating revenues per recommendation in FY 2009-10 TSJ audit report.

**The \$350,000 incentive fee is different than what the external auditor reported in the 2010-11 audited financial statement. The external auditor used the incentive amount that TSJ received in FY 2010-11 which was \$250,000. In conformance to the Management Agreement, we used what TSJ earned in FY 2010-11 which was \$350,000.

Calculation of Net Loss Should Be Clarified in the Agreement

As noted above, TSJ reported a more favorable net loss than the net loss that we calculated in Exhibit 4. TSJ calculated a net loss of \$1.88 million, whereas we calculated a net loss of \$2.4 million. After asking City staff and TSJ staff to help us explain this discrepancy, we learned that the Management Agreement contained two separate paragraphs each with different requirements as to how the GOP is to be computed.

Because section 4.8 of the Management Agreement regarding calculation of GOP was silent on the treatment of management fees, TSJ's Chief Financial Officer (CFO) sought guidance from City staff who told the CFO to exclude the *fixed minimum management fee* (\$150,000) and the *incentive fee* (\$350,000) from the calculation of the gross operating loss. As shown in Exhibit 4, there are three components of the management fee: (1) the \$150,000 fixed minimum management fee specified in section 7.2 of the Management Agreement, (2) the \$350,000 incentive fee specified in section 7.3, and (3) the \$600,000 executive management fee specified in section 7.1.

Section 7.1 clearly states that *"the Fixed Executive Management fee shall not be considered an Operating Expense and therefore will be charged below the Gross Operating Profit line of the Income Statement. Any additional expenses associated with Executive Compensation shall be considered an Operating Expense and will be charged above the Gross Operating Profit line of the Income Statement."* Our calculation follows section 7.1 of the Agreement and includes the *fixed minimum management fee* and the *incentive fee* as expenses above the line in the GOP calculation. So, part of this discrepancy is largely the result of where we follow the guidance in one paragraph and TSJ (with City staff approval) followed the guidance in the other paragraph.

The differing calculations do not change the fact that TSJ met its FY 2010-11 performance target for GOP. Under either scenario, TSJ met its performance target. However, to avoid any confusion in future years, we believe that the language in the management agreement needs to be clarified. Since the City is in conversation with TSJ about the need for a few other technical changes to the management agreement, the best approach might be to wait to make this clarification along with any other changes are put in place.

Recommendation #1: To ensure consistency from year to year in how the TSJ computes its gross operating profit, we recommend that the City and TSJ work together on clarifying the conflicting language in the management agreement.

Results of Operations

TSJ's FY 2010-11 operating results can be mostly attributed to cost cutting measures that TSJ took in FY 2010-11. TSJ reduced overall personnel expenditures. Also, Team San Jose reduced the size of its staff, and implemented cost controls that generated savings, such as instituting a volume purchasing strategy for all venues under management by Team San Jose.

TSJ's second year of operating food and beverage service showed continued growth. In FY 2009-10, TSJ demonstrated modest results after it brought food and beverage services in-house. However, FY 2010-11 shows that TSJ has been

able to profitably operate catering services and food and beverage services at the Facilities. Despite the minor increase in attendance and fewer events, TSJ had a net profit of \$3.2 million, on gross revenues of \$8.4 million in food and beverage operation with TSJ staff. This was an increase of about \$1.6 million from the previous year. Before bringing food and beverage services in-house, as stipulated in its contract with Centerplate, TSJ was paid a fixed fee of 24 percent of gross revenue from the food service activity. However, now that TSJ has brought food and beverage services in-house, the margin (after discounts used to incent clients) was 36.7 percent.

TSJ saw a number of fluctuations in its revenues and expenses since FY 2009-10. Ticketing service revenue (and associated expenses) declined due to the suspension of Nederlander concerts and associated merchandise revenue related to these concerts. The delay in launching of concerts was due to contract delays and construction delays of the San José Civic. The suspension also decreased expenses related to contracted outside services and equipment rentals that are associated with the suspension of the concerts. TSJ is also experiencing a decline in telecommunication services as clients have increasingly brought in their own services. Finally, TSJ had adopted more aggressive collection efforts and tighter deposit requirement which helped improve their bad debt expense.

Regarding TSJ expenses, total salaries for TSJ employees grew from previous years due to the hiring of former City employees. TSJ also used variable labor, decreasing personnel costs, which helped to increase its overall food & beverage revenue, facilities services and overall customer service improvements. On the other hand, the reduction in City employees decreased overall City overhead. Worker's compensation premiums were also reduced due to TSJ's change to a variable labor model.

With regards to revenues, TSJ grew revenue to \$18.8 million -- \$4.9 million over the adopted budget. This increase was mainly due to a specific push to book short-term business in the Convention Center.

TSJ Relied on TOT Revenues to Cover \$2.5 Million in Operating Losses in Convention Center Events

An important source of revenue is the rental of exhibition and meeting space to the organizations and corporations that sponsor conventions, professional meetings and exhibits at San José's convention center. In FY 2010-11, gross revenue from the rental of building space was down slightly from the prior year, \$4.5 million to \$4.3 million (including rental of the cultural facilities). The decline in building rental revenue from renting the convention center was due to fewer events at the convention center. Altogether, TSJ was able to attract about 976,000 people in FY 2010-11, resulting in just over 200,000 hotel room-night

bookings⁶; however the Convention Center sustained a \$2.5 million operating loss⁷. It should be noted that convention center events helped to generate an estimated economic impact of \$77.8 million in FY 2010-11.

Overall Net Profit on Events at the Cultural Facilities

Overall, TSJ's operation of the cultural facilities resulted in \$302,000 in net profit. This is a significant increase from 2009-2010 figures in which overall losses from the operation of the cultural facilities totaled \$1.9 million. Exhibit 5 shows the profit and loss by cultural facility.

Exhibit 5: Profit and Loss for the Operation of the City's Cultural Facilities⁸

	San José Civic	Center for the Performing Arts	California Theater	Montgomery Theater	Total
Revenues	\$623,000	\$2,437,000	\$455,000	\$257,000	\$3,772,000
Expenses	\$962,000	\$1,624,000	\$502,000	\$382,000	\$3,470,000
Profit (Loss)	(\$339,000)	\$813,000	(\$47,000)	(\$125,000)	\$302,000

Source: Auditor analysis of Team San Jose accounting records.

In last year's performance audit, we highlighted Team San Jose's \$1 million loss associated with its effort to stage concerts at the Civic auditorium. And, since the concert series was ultimately suspended until funding could be secured to complete needed renovations for the Civic, we recommended that Team San Jose's contract with its concert promoter, Nederlander, be renegotiated so that the contract better balance the financial risk of doing concerts between Team San Jose and the promoter.

As of December 2011, TSJ has negotiated new contracts with Nederlander Concerts: a new Civic Auditorium Agreement and Consulting Agreement. According to TSJ, these contracts have been approved by the TSJ Board, the City Manager's Office, the City Attorney's Office, and the City's Bond Counsel. The former Civic Auditorium Agreement was terminated effective June 30, 2011.

⁶ Total includes 389 hotel nights that TSJ took credit for even though TSJ paid for the 389 room nights for the organizing staff of a major sports event held in San José in Summer 2010. See page 35 for a further description of this transaction.

⁷ The loss associated with the convention center operations includes the full cost of the City's overhead and bad debt expenses charged to the Convention and Cultural Affairs Fund, as well as nearly all of the cost of TSJ's administrative personnel. It does not include Convention Center debt payments.

⁸ Figures includes food & beverage, ticketing, and event production revenues and expenses.

TSJ Cut Costs in 2010-11

In the *FY 2009-10 Annual Performance Audit of Team San Jose's Management of the City's Convention and Cultural Facilities*, we recommended, "In light of the continuing difficult economic conditions, and taking into account that TOT transfers are projected to remain well below previous amounts, we recommend Team San Jose be prepared to reduce spending below the budgeted level during difficult economic times."

In line with the recommendation, TSJ reduced spending for FY 2010-11. In FY 2010-11, TSJ implemented cost savings measures that reduced operating expenses by 15%. The City's FY 2010-11 adopted operating budget for the Facilities eliminated positions for 42 City employees who had worked at the Convention Center, which resulted in savings of \$2.8 million. However, personnel costs for Team San Jose employees and variable labor rose by about \$1.6 million⁹ in the same year resulting in an overall net savings of \$1.2 million.

The following additional cost savings measures were implemented throughout the year:

- Reduced overall personnel expenditures;
- Union contracts were renegotiated to freeze increases for FY 2010-11;
- Cost controls and standard operating procedures were implemented, including:
 - Volume purchasing reduced Cost of Sales by 1% of total Food & Beverage Revenue;
 - Renegotiated contracts (uniforms, linens, maintenance, etc.);
 - Strengthened approval process for contract approval with the board and City; and
 - Tightened approval process for cost spending.

Fewer projected events due to the convention center expansion and renovation is expected to also lower related expenses. This along with the cost savings mentioned above, are projected to reduce operating expenses from \$21 million for TSJ operations in FY 2010-11 to \$16 million in for FY 2011-12.

⁹ Increase in Team San Jose personnel costs were due to hiring of some former City of San José employees and use of variable labor.

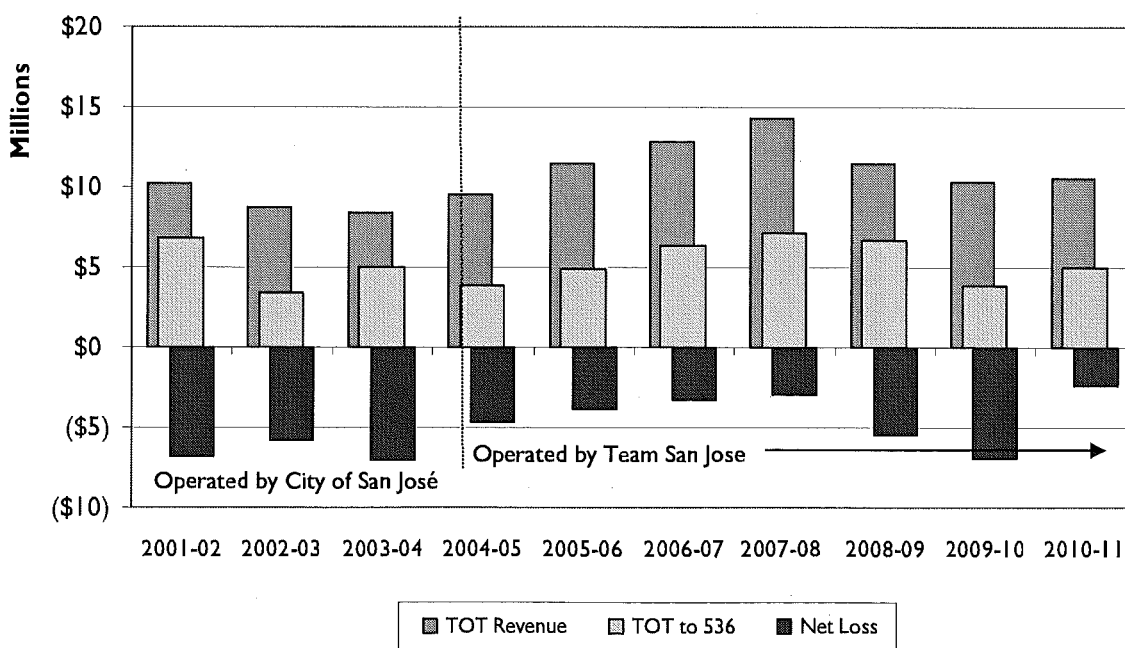
Transient Occupancy Tax Revenues Appear to Have Stabilized

In FY 2010-11 the fallout from the economic recession continued to impact the convention and visitors business. According to the Budget Office, the level of TOT (also known as hotel tax) collections is directly related to the status of the economy. When the economy declines, convention, business travel, and tourism activity decrease, which leads to lower occupancy rates in the hotels. With decreased occupancy, the hotels tend to reduce room rates in an effort to retain and attract business, which negatively impacts TOT collections. Conversely, when the economy is growing, TOT revenues tend to increase.

In 2008-09, TOT collections fell approximately 20% below 2007-08 levels. In 2009-10, collections fell by an additional 9.7%. While TOT receipts will have to increase significantly to get back to peak levels (FY 2007-08), it does appear that collections have stabilized and some modest growth is being experienced as average room rates, occupancy rates, and revenue per available room have increased from 2009-10 levels. As a result, 2010-11 year-end collections exceeded the budgeted level by 8.5%, or \$872,000, of which \$436,000 was dedicated to Fund 536 in the 2010-2011.

Exhibit 6 shows the TOT Fund revenues, the amount of TOT revenues that is transferred to Fund 536, and the net loss from the operations of the Facilities by the City from 2001-02 to 2003-04, and by TSJ from 2004-05 onwards.

Exhibit 6: Transient Occupancy Tax Fund Revenue Compared to the Facilities' Net Loss

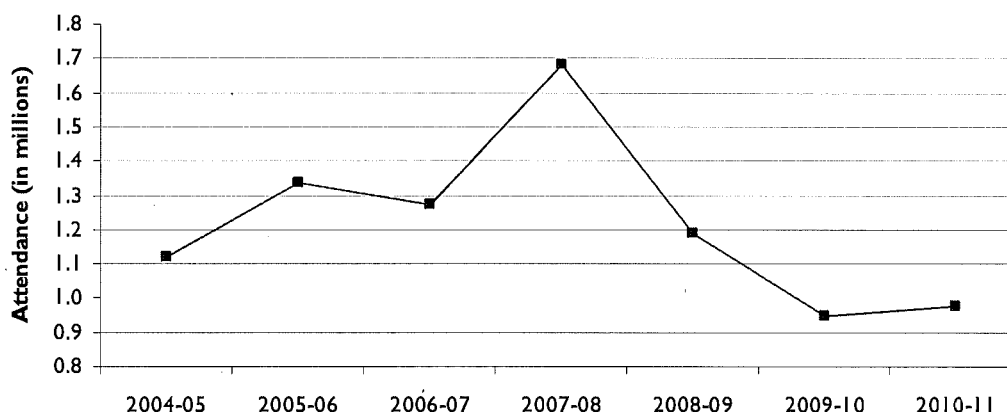


Source: Auditor analysis of Budget Office documents and audited financial statements for the Convention and Cultural Affairs Fund.

Event Attendance Increased by 3 Percent in FY 2010-11

While TSJ experienced a 20% decrease in attendance in FY 2009-10 from the previous year, it saw a modest increase of 3% in FY 2010-11. However, TSJ booked slightly fewer events in FY 2010-11 – 280 events vs. 288 in the previous year. Exhibit 7 displays attendance at events from FY 2004-05 to FY 2010-11.

Exhibit 7: Event Attendance at the Convention and Cultural Facilities from FY 2004-05 to FY 2010-11



Source: Auditor analysis of audited financial statements for the San Jose Convention and Cultural Facilities Fund and TSJ attendance records.

Positive Outlook

Industry professional have a positive outlook on meeting attendance for the short-term future. According to surveys by the Professional Convention Management Association, an association of convention industry leaders:

- One-quarter (25%) of meeting planners expected the number of meetings they booked in 2010 to increase compared to 2009, and three in ten (31%) expected this trend to carry over into 2011. An average of 17 more meetings each were expected for 2010 and 2011 respectively.
- One-third (34%) of meeting planners expected meeting attendance to increase in 2010, while more than four in ten (44%) expected this trend to continue into 2011.

The Use of Discounts to Boost Attendance

To boost attendance at Convention Center events and profitability, TSJ offers discounts to potential customers as discussed in Finding III. During 2010-11, TSJ offered a number of discounts to its clients relative to what TSJ says it would

charge in a good economy, in order to remain competitive and attract business. TSJ states that providing discounts to potential clients is common practice in the convention industry.

Changes to TSJ Board of Directors

Another notable change from the prior year was in the area of governance. TSJ made the following board changes in the last two years to improve transparency and governance:

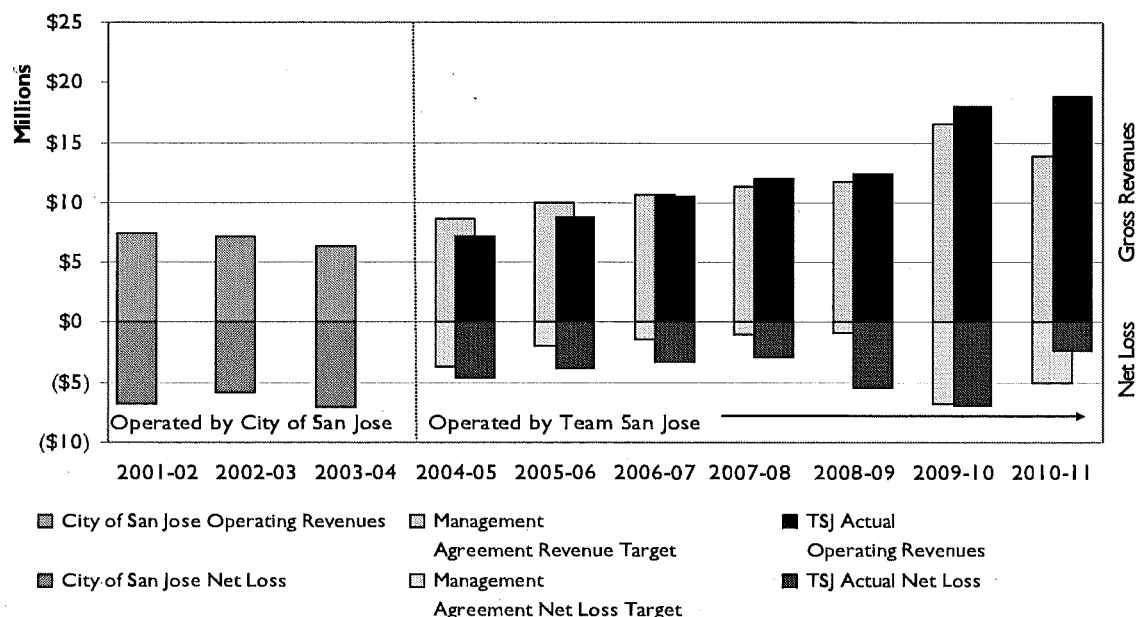
- Restructured the board from a 28-member board to a 15 member board;
- Eliminated the Executive Committee which previously provided oversight and had decision-making authority on behalf of the Board;
- Reduced the number of committees, reassigned and streamlined committee responsibilities;
- Added a City Manager liaison and City Council liaison to the Board;
- Formalized an Audit Committee and a Personnel Committee;
- Formalized Finance Committee responsibilities to include IRS Form 990 requirements;
- Improved transparency: Implemented IRS Form 990 rules that required approval of contracts for multi-years and contracts exceeding \$250K as well as any business decisions that would change the Gross Operating Profit or Revenue by \$250K;
- Strengthened communication:
 - Improved reporting package, clearly reporting revenue and expenses compared to the approved appropriations;
 - Monthly board meetings reviewing financial results, operational decisions, and contracts.
 - Quarterly performance reports to the Mayor and City Council.

In FY 2010-11, Facilities Have Reached Its Highest Gross Revenue and Lowest TOT-Subsidized Net Loss Since FY 2004-05 (as Calculated in Conformance with the Management Agreement)

As shown in Exhibit 8 below, gross revenues are more than double as compared to the first year when TSJ operated the Facilities in FY 2004-05. In FY 2010-11, \$11.9 of this revenue was due to the second year in which TSJ brought in-house business such as food & beverage and event production services. In prior years, food & beverage were presented on a net basis, whereas food & beverage is now presented on a gross basis.

While in 2009-2010, we witnessed the Facilities' operations highest net loss of \$6.9 million since TSJ began operations, in 2010-11 we saw a dramatic decline in net loss to \$2.4 million. In 2010-11, operations have achieved the highest gross revenues (\$18.8 million) and lowest TOT-subsidized net loss since TSJ began managing the Facilities.

Exhibit 8: Revenues and Net Losses from the Operation of the Facilities from FY 2001-02 to FY 2010-11



Source: Auditor analysis of audited financial statements for the San Jose Convention and Cultural Affairs Fund. Revenues and losses are calculated in accordance with the Management Agreement.

Ending Fund Balance Grew in FY 2010-11

Exhibit 9 below illustrates the different funding sources for the operation of the Facilities from FY 2004-05 to FY 2010-11. According to the Office of Economic Development (OED), the operating transfer from the Transient Occupancy Tax (TOT) Fund is determined by using a formula where a portion of the TOT tax

receipts are transferred to the Convention and Cultural Affairs Fund (Fund 536), the Convention and Visitors Bureau, and to the Office of Cultural Affairs. As shown below, transfers from the TOT Fund 536 totaled \$5 million in FY 2010-11. In prior years, the transfer from the General Purpose Parking Fund was all revenue collected at the Convention Center garage, less the amount of any capital repairs and expenses at the garage.¹⁰ The General Fund transferred about \$48,000 of reimbursements in FY 2010-11.

Exhibit 9: Budgeted Sources and Uses for Fund 536 (Convention and Cultural Affairs Fund) from FY 2004-05 through FY 2010-11

	2004-05 Actual	2005-06 Actual	2006-07 Actual	2007-08 Actual	2008-09 Actual	2009-10 Actual	2010-11 Actual	2011-12 Estimated Budget
Sources of Funds								
Beginning Fund Balance	\$(491,171)	\$(101,660)	\$728,779	\$ 4,402,575	\$8,295,598	\$10,338,062	6,837,010	8,916,815
Revenues*	6,719,381	8,750,372	10,257,058	11,544,681	11,612,668	17,829,414	18,673,338	15,647,548
Transfers from General Fund	1,725,000		1,145,857			250,000	47,967	0
Transfers from General Purpose Parking	620,000	892,823	583,000	1,249,973	833,000	450,000	450,000	0
Transfers from Transient Occupancy Tax	3,813,083	4,922,103	6,338,040	7,213,565	6,732,085	3,889,922	5,017,865	5,582,211
Other	480	3,625	20,145	16,213				
Total	\$12,386,773	\$14,467,263	\$19,072,879	\$24,427,007	\$27,473,351	\$32,757,398	\$31,026,180	\$30,146,574
Uses of Funds								
Expenditures	\$12,279,487	\$13,541,254	\$14,419,553	\$15,883,037	\$16,891,421	\$25,638,685	21,775,186	23,660,612
Other	208,946	197,230	214,393	248,372	243,868	287,023	334,179	554,254
Total	\$12,488,433	\$13,738,484	\$14,633,946	\$16,131,409	\$17,135,289	\$25,925,708	\$22,109,365	\$24,214,866
Ending Fund Balance								
Unrestricted	\$139,371	150,320	4,080,356	7,106,113	8,845,012	5,275,476	7,375,695	3,724,294
Facilities Maintenance Reserve	-	-	-	500,000	1,000,000	1,000,000	1,000,000	1,000,000
Other	(241,031)	578,459	338,432	689,485	493,050	556,215	541,120	1,207,414
Total	\$(101,660)	\$728,779	\$4,418,788	\$8,295,598	\$10,338,062	\$6,831,691	\$8,916,815	\$5,931,708

Source: San José Convention Center and Cultural Facilities Fund statements of source and use from the City Manager's Budget Office

*Includes minimal interest revenue.

¹⁰ In years prior to FY 2009-10, convention center and theater operations received parking transfer net of expenses. In FY 2009-10 and 2010-11, the parking transfer was a flat transfer of \$450K. Fund 536 is still projected to have a positive fund balance at the end of construction, consistent with the March 1, 2011 Council memorandum.

As mentioned earlier, like other convention centers, TSJ has been challenged with a nationwide downturn in the convention business. TSJ and the City have had long-standing plans to improve the Facilities, and have been making efforts to set aside funding in Fund 536.

In FY 2009-10, we shared our concerns regarding the Fund's depletion where it could jeopardize the City's plans to subsidize operations during the upcoming convention center expansion. However, in FY 2010-11 the Facilities' operating revenues, and TOT revenues outpaced operating expenditures and the Fund reflected this growth. By June 30, 2011, its unrestricted ending fund balance was \$7.4 million -- an almost 40% increase from the prior year.

However, the City anticipates the unrestricted ending fund balance will decrease again in FY 2011-12 to \$3.7 million. According to the Budget Office, this anticipated decrease is due to the effect of the convention center construction on business and capital needs for the theaters. Concerns will be mitigated if TSJ continues to grow operating revenues, while managing net losses. While the City significantly reduced its spending in FY 2010-11, we still caution that in order to ensure the fiscal health of the City's convention and cultural facilities and protect their ability to generate an economic impact, the City should:

- a) Continue to review its estimates on how much will be needed to support continued operations during the upcoming Convention Center expansion;
- b) On an ongoing basis ensure that Fund 536's budget is balanced without use of fund balance to support operating losses; and
- c) Once the economy improves, create a reserve for economic uncertainty in Fund 536.¹¹

¹¹ In developing the budget for FY 2011-12, additional strategic reserves were established: 1) Revenue Stabilization Reserve to protect against unexpected decreases in TOT receipts and operating revenue (this reserve was set at 10 percent of projected TOT collections); and 2) Capital Repairs Reserve to allow for necessary capital repairs at the facilities (this reserve was set at \$151,657 in FY 2011-12 with budgeted increases for subsequent years). A \$1 million Maintenance Reserve has existed in Fund 536 for a number of years.

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Finding II Team San Jose Met 7 of Its 9 Performance Targets for FY 2010-11

Summary

The 2009 Management Agreement and addendum require Team San Jose to report annual performance measures and to adhere to agreed-upon targets for its incentive measures. These incentive targets are the basis for the City's incentive payments to TSJ. The City's annual incentive payment grows as TSJ exceeds targets. In FY 2010-11, TSJ drew nearly 1 million people to events at the Facilities, resulting in more than 200,000 hotel night bookings. Overall, it achieved a weighted incentive performance of more than 115 percent, earning the maximum incentive fee of \$350,000.

Team San Jose Met Most Performance and Incentive Targets

Based on our review of the audited financial statements for the Convention and Cultural Facilities, audits of hotel night bookings, Team San Jose's attendance figures, customer surveys, and other records, we found that Team San Jose:

- Met targets for seven of the nine performance measures, resulting in a total weighted performance score of 151.3 percent; and
- Met targets for six of the eight incentive measures, resulting in a total weighted incentive fee score of 118.3 percent.

In the area of economic impact, Team San Jose met all 4 of its performance measures - **event attendance**, **hotel-nights**, **estimated economic impact** and **return on investment**.

In the area of gross revenue and gross operating profit, FY 2010-11 was a successful year for Team San Jose. TSJ exceeded its **gross revenue** target of \$13.9 million due in large part to a \$2.0 million increase in revenue over the prior year from TSJ's food and beverage operation. The food and beverage increase was offset in FY 2010-11 by a slight decline in revenue from the rental of building space over FY 2009-10.

Another success for Team San Jose was in the category of **gross operating profit** in which it lost only \$2.4 million, much less than the previous year and less than its 2010-11 target of a \$5.1 million loss. Trimming its losses as TSJ did in FY 2010-11 reduces the operating subsidies that the City must transfer to TSJ in the form of TOT revenues and reimbursements from the City's General Fund.

In the category of theater performance, that is **performance days** and **occupied days**, TSJ fell short of its FY 2010-11 performance targets, while it met its performance target for **customer satisfaction** as shown in Exhibit 10.

Team San Jose Achieved the Maximum Incentive Payment

Exhibit 10 shows the weighted scores for incentive payment based on the weights given to each incentive measure. Appendix A describes each of the individual measures and explains how the scores are calculated.

Exhibit 10: Scores for Team San Jose's FY 2010-11 Performance and Incentive Measures

Measures	Target	Result	Goal Met?	Performance Weight Score		Incentive Weight Score	
Economic Impact							
Hotel Nights	200,000	200,139 ¹²	Yes	10%	10.0%	15%	15.0%
Event Attendance	853,000	975,550	Yes	10%	11.4%	10%	11.4%
Estimated Economic Impact	\$65,000,000	\$77,763,878 ¹³	Yes	10%	12.0%	15%	17.9%
Return on Investment	\$2.21	\$2.68	Yes	10%	12.1%	n/a	0.0%
Gross Operating Profit/Revenue							
Gross Operating Revenue	\$13,900,000	\$18,803,258	Yes	n/a	n/a	40%	54.0%
Gross Operating Profit	(\$5,100,000)	(\$2,378,154)	Yes	40%	85.8%	n/a	n/a
Theater Performance							
Performance Days	312	297	No	7%	6.7%	7%	6.7%
Occupied Days	661	624	No	3%	2.8%	3%	2.8%
Customer Service							
Satisfaction Rate	92%	98%	Yes	10%	10.3%	10%	10.3%
Total Weighted Score					151.1%		118.3%

Source: Auditor analysis of amendments to FY 2009-2014 Management Agreement, audited financial statements, attendance reports, and other Team San Jose records.

Note: Weighted scores are the product of the measure weights listed in Exhibit 3 in the Background, and the percentage of actual performance with respect to the goal. For instance, estimated economic impact is given a weighted incentive score of 17.9% because estimated economic impact was 119.6 percent of target and it is assigned a weight of 15 percent. 119.6 percent x 15 percent = 17.95%.

Incentive Fee Structure

Along with performance measures, the Management Agreement also includes incentive targets and a corresponding incentive fee structure. The performance

¹² Hotel-Nights achieved includes 389 hotel-nights that TSJ took credit for even though TSJ paid for the 389 room nights for the organizing staff of a major sports event held in San Jose in Summer 2010. See page 30 for a further description of this transaction.

¹³ Team San Jose's result for estimated economic activity includes a modest amount of impact that was the result of TSJ, San Jose Hotels, Inc., and a number of other organizations providing subsidies to a several meeting groups.

and incentive measures provide a quantifiable way of evaluating TSJ's management of the convention and cultural facilities. Using the incentive fee structure, the City makes incentive payments based on TSJ's performance. In the FY 2009-10 performance audit, we recommended that the incentive fee payment structure be revised such that TSJ receives incentive payments only if it achieves a specified threshold. This was accomplished by separating what was previously known as the "incentive fee" into two parts – the fixed executive management fee and the incentive fee (as shown in Exhibit 4). In our prior analysis, we also found that the incentive fee was not structured to incentivize performance that exceeds expectations. The incentive fee schedule has since been revised and is shown in Exhibit 11.

Exhibit 11: Incentive Measure Payment Schedule

Incentive Fee Schedule	
Weighted Incentive Fee Score	Incentive Fee
Less than 100%	No incentive fee
At least 100% but less than 110%	\$200,000
At least 110% but less than 115%	\$300,000
115% or greater	\$350,000

Source: Second Amendment to Management Agreement between TSJ and City

Team San Jose Performance Targets as Compared to Actual from FY 2004-05 to FY 2010-11

Exhibit 12 shows a history of Team San Jose's performance measures for the past eight years since it began operating the Facilities, including the performance targets for next year, FY 2011-12. The exhibits also show Team San Jose's actual performance for FYs 2004-05 to 2010-11.

We would like to note that the amended Management Agreement term began in FY 2009-2010. As part of the amended agreement, performance measures would undergo a negotiation and Council-approval process annually. This was unlike the prior agreement in which performance targets were negotiated for each year for the entire five-year period in which the agreement was in effect (i.e. FY 2004-05 through FY 2008-09).

Summary of Performance

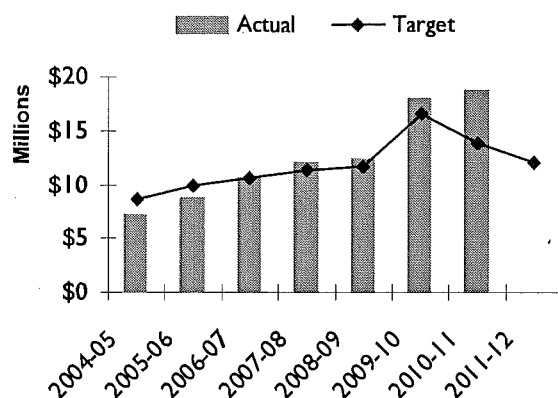
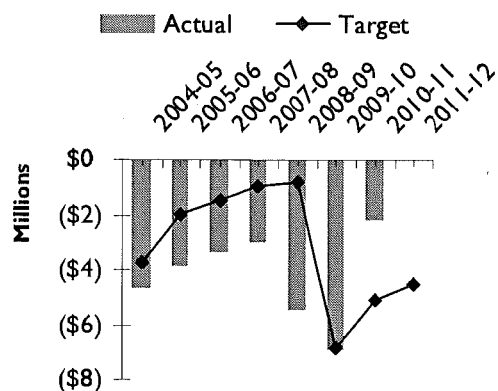
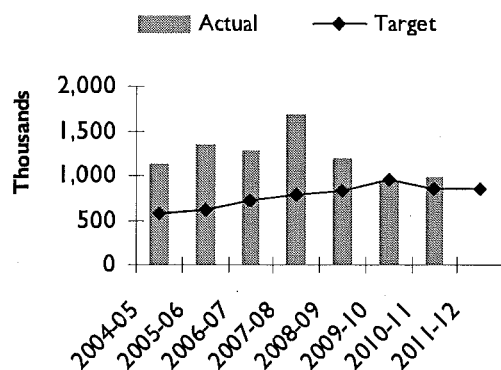
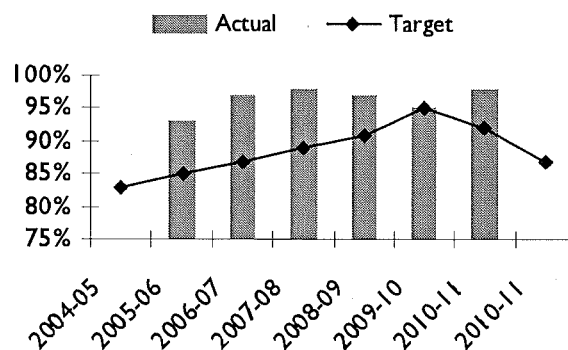
As Exhibit 12 shows, in 4 of the last 7 years, Team San Jose has achieved its gross revenue targets. For the past four fiscal years, TSJ exceeded its gross revenue targets, as TSJ's actual gross revenue trended noticeably higher. Another positive

outcome was that FY 2010-11 was the first year that Team San Jose met its target for Net Loss. This was the result of an increase in Team San Jose's gross revenue in FY 2010-11 and a significant reduction in TSJ's operating costs. Although TSJ's trend for attendance is down from its peak in FY 2007-08, TSJ has achieved its targets for attendance in six of the last seven years. For customer satisfaction, Team San Jose met its targets for all but one of the past six years.

Team San Jose's FY 2010-11 performance measures were adjusted to reflect the assumed impacts of the convention center expansion and renovation. The City and Team San Jose assumed that:

- Revenue from the convention center would be approximately 20% lower than the contracted level because of temporary impacts resulting from construction; and
- Other performance measures would be impacted by a 30% reduction to total visitors, visitor spending, and/or estimated economic impact.

Exhibit 12: Comparison of Targets to Actual FY 2004-05 to FY 2010-11

Gross Revenues Target vs. Actual
(FY 2004-2011)Net Loss Target vs Actual
(FY 2004-2011)Attendance
Target vs. Actual (FY 2004-2011)Customer Satisfaction
Target vs. Actual (FY 2004-2011)

*Insufficient data collected for FY 2004-05

Source: Auditor analysis using 2004-2009 Management Agreement, Addendum to the Management Agreement, previous TSJ performance audits, City memos and the 2010-11 audited financial statement for the Facilities.

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Finding III CVB Operates Under a Separate Agreement with the City of San José

Summary

The CVB's mission is to enhance the image and economic well-being of San José as a globally-recognized destination. The CVB provides a comprehensive sales and marketing program to advertise, promote, and publicize the City to achieve as the City's first priority for the CVB, the goal of booking conventions, trade shows, conferences, and other events at the Convention Center and area hotels.

CVB Funding and Staffing

In fiscal year 2010-11, the Team San Jose received a total of \$3.8 million in CVB revenue, including \$2.7 million in TOT revenues to support the activities of the CVB. TSJ received an additional \$1.1 million from the General Fund and another \$37,000 from the Airport to support its CVB activities.

Exhibit 13 shows the all transfers to the CVB. Total transfers in FY 2010-11 were \$3.8 million.¹⁴

Exhibit 13: Total City Transfers from FY 2009-10 to FY 2011-12

	FY 2009-10	FY 2010-11	FY 2011-12
TOT Allocation to CVB	2,138,279	2,702,250	2,984,423
General Fund Allocation to CVB	1,708,296	1,094,267	554,369
Airport Operations and Maintenance Fund	74,875*	37,000	37,000
Fund 536			600,000
TOTAL	\$3,921,450	\$3,833,517	4,175,792

Source: Budget Office

*Estimated.

¹⁴ It is expected that the General Fund will not be allocating money to CVB in 2012-13. According to the Mayor's June 2011 Budget message, "Given the extent of next year's budget deficit, organizations that receive grants and subsidies should be prepared not to receive funding in Fiscal Year 2012-13."

In addition, the CVB generated \$336,000 in revenue for providing registration and housing services for those of its convention attendees who choose to take advantage of these services. This also includes \$150,000 in hotel partnership fees charged to convention hotels for promotional business development services.

In FY 2010-11, most of the CVB's \$4.1 million in expenses were personnel costs associated with CVB staff.

Event Booking

The primary goal of the CVB is to book events at the convention center, especially events that will bring out of town visitors to San José, who end up staying in San José hotels. To achieve this goal, the Convention and Visitor's Bureau has established three distinct teams - the Sales team, the Marketing team, and the Public Affairs and Communication team. To generate sales leads for convention center business, the sales team attends trade shows around the country, as well as conducts familiarization tours for meeting planners interested in holding a convention or meeting at the convention center or a San José hotel. The sales team is paid commissions based on individual and team goals for the booking of hotel room nights, hotel room night leads, rental of convention center space, and personal performance factors. In FY 2010-11, Team San Jose paid about \$180,000 in commissions to its Sales staff.

Marketing and Public Affairs

The role of the marketing and the public affairs team is to raise the awareness of San José as a meeting destination. The team promotes awareness of local events by such activities as making advertising purchases in trade publications and elsewhere, by maintaining the website "sanjose.org", by distributing brochures and mailers, and by hosting events for City-wide groups that may lead to a group holding their event in San José.

Activity Measures for the Sales, Marketing and Public Affairs Team

The CVB has developed a set of internal measures or activity goals that it has presented in its marketing plan for tracking and reporting the accomplishments of the CVB's sales and marketing efforts. In accordance with its management agreement with the City, Team San Jose has developed a marketing plan (plan) that outlines the activities of each of the teams within the CVB. The plan also sets forth for each department a set of deliverables that the CVB has agreed to track annually. For example, one of the performance measures that Team San Jose has set for the marketing and communications teams is for the team to generate 3 million impressions on its target audiences, by purchasing advertising and generating media articles for San José events, facilities and destination offerings. Similarly, the success of the Sales Team is evaluated based on various performance factors. One such factor is the number of hotel room-nights that

the sales team generates. Another example of a performance measure, actually an activity measure, for the Sales Team is that it has agreed to participate in at least 36 tradeshow events in FY 2011-12 in select markets across the country to raise awareness of San José as a meetings destination.

Team San Jose reports on its operating and financial results monthly and in an end-of-the-year report to the Public Safety and Finance Committee. In these reports, Team San Jose includes information on the accomplishment of its activity goals. For example, in the June 2011 report which also included monthly and full year data on CVB's accomplishments, Team San Jose reported that its sales team attended 33 trade shows in FY 2010-11. However, TSJ's monthly report does not display what the annual target was for FY 2010-11. This is also true for other CVB performance measures that Team San Jose reported on. We believe that in its monthly and end of the year report that Team San Jose should present the CVB's accomplishments alongside the targets it set for itself for a more meaningful presentation.

Recommendation #2: To make its reporting of its results more meaningful to readers, we recommend that Team San Jose reformat its monthly report so that CVB's accomplishments for the month covered are shown next to the Team San Jose's performance targets.

Separate Accountability for the Merged CVB and Team San Jose May No Longer be Needed

For some aspects of the operation, the City still treats the CVB and the convention and cultural facilities as though they were separate organizations. In 2009, the City merged the CVB into the Team San Jose organization, in effect making CVB Team Jose's sales and marketing team. However, there still exist remnants of the previous organizational arrangement in which the CVB was a separate organization from TSJ.

Given that both the CVB and the convention and cultural facilities share the goal of booking groups into the convention center and generating out of town visitors to San José, we believe that it no longer makes sense for the CVB to be treated as though it were an entity separate of Team San Jose. For example, the CVB operates under a separate set of performance targets than Team San Jose, even though three of four CVB's performance goals are the exact same goals as that of Team San Jose.¹⁵ Also, the City's management agreement with Team San Jose

¹⁵ The CVB operates under a separate contract which requires submission of an annual Marketing Plan. This marketing plan should include performance goals and criteria for the occupancy of the Facilities, attendance, hotel night bookings, and delegate spending estimates. The CVB, as a representative in the Mayor's Communication Working Group is required to submit a marketing plan each year. We understand that these performance targets are separate from those stated in the Management Agreement.

requires that the TSJ maintains a separate set of accounting records for the CVB and a separate set of accounting records for the convention and cultural facilities. In addition, CVB is subject to a separate annual financial audit.

Since the primary purpose of the CVB is to advertise, promote, and publicize the City toward achieving the goal of booking conventions, trade shows, conferences, and other events at the Convention Center and area hotels, we see no reason to continue to keep separate these aspects of the CVB's operation from that of the operation of the convention and cultural facilities.

Furthermore, even though CVB is part of Team San Jose, the CVB has been operating under a separate operating agreement with the City. The City entered into an agreement with the CVB in June, 2000 for the period July 1, 2000 to June 30 2005, with one additional five-year option which was exercised extending the Agreement from July 1, 2005 to June 30, 2010. The contract has since had five amendments with the most recent amendment extending the agreement to December 31, 2011. In December 2011, the City Council directed the City Manager to negotiate a new CVB Agreement with TSJ for the period of January 1, 2012 to June 30, 2014, with two additional three-year options.

The current arrangement adds a layer of complexity that we believe is no longer justified. In accordance with proposed CVB agreement, the performance measures for the CVB are to be presented in the budget for TSJ. Two of the CVB's proposed performance measures (shown in highlighted rows in the following exhibit) are identical to the performance measures already in place for the convention and cultural facilities. The performance measures for TSJ are discussed in Finding II of this report.

Exhibit 14: Convention Facilities Activity and Workload Highlights¹⁶

Activity and Workload Highlights	2010-11 Forecast	2010-11 Actual Results	Goal Met?
Number of Events at Convention Center and Theaters	226	280	Yes
Performance days at Theaters	312	297	No
Delegate Expenditures	\$65 million	\$77.8 million	Yes
Hotel Rooms Booked by Team San Jose	200,000	200,139	Yes

Source: FY 2010-11 Adopted Operating Budget

As Exhibit 14 shows, the TSJ met three of its four performance goals for FY 2010-11.

¹⁶ See footnote above.

Recommendation #3: In recognition of the shared strategic direction of the convention and cultural facilities and the CVB, we recommend that the City consolidate the two operating agreements with the Team San Jose and the CVB into one agreement. The best time to consolidate the two agreements will be June 2014, when both agreements expire. We recommend that the City adopt a single agreement that covers both the convention and cultural facilities and the CVB and that establishes one set of performance measures for Team San Jose. Also, a new single agreement should eliminate the requirement for a separate set of accounts and separate financial audits for each of the two organizations.

Subsidies

One of the strategies that the CVB uses to promote hotel stays in San Jose is to provide subsidies to groups who commit to hold their major events in San Jose. This appears to be a common practice for convention and visitor bureaus around the country. For selected clients each year, the Team San Jose actually agrees to subsidize the client, either in the form of a cash payment or another form of compensation, if the client commits to hold their event in San Jose. In accordance with Team San Jose's guidelines for allowing subsidies, a group that is to receive a subsidy must be expected to generate a minimum number of hotel room nights related to the event. Also, for subsidies over \$25,000, the Director of Sales must request special permission in advance from the Chief Financial Officer.

According to its Senior Vice President of Sales for Team San Jose, a number of factors are taken into account in deciding on whether or not to allow a subsidy to a group. These include the following:

- Total hotel room-nights that the group will generate;
- Opportunity for repeat business with the group; and
- Total number of people projected to attend the group's event.

Example of a Subsidy

One example of a subsidy occurred in July/August 2010, when Team San Jose agreed to provide an \$86,000 subsidy to the a national sports group. According to TSJ, in summer of 2010, the group held their event in San José generating an estimated 7,607 hotel room-nights and 10,000 visitors to San Jose and an estimated \$100,000 in TOT revenue to the City. The group also was in San José in 2008. Furthermore, the group plans to hold their annual event in San José

again in 2012 and 2014, which is projected to general additional economic impact. According to TSJ, total business opportunity from this group from 2008-2012 and 2014 is projected to total 41,373 room nights and \$419,179 in TOT revenues.

Of the \$86,000 subsidy, \$65,000 was to the national sports group in the form of a cash payment. This payment was made out of the Hotel Business Improvement District (HBID) funds, which are those funds collected for the purpose of increasing hotel occupancy in San José. The Board of Directors of San Jose Hotels, Inc, made the decision to provide a subsidy out of the HBID monies. The group was in San José to hold their annual event. The remaining \$21,000 of the \$86,000 subsidy was in the form of a payment by CVB for hotel rooms at the City-owned Hayes mansion for the group.

Impact of Subsidies on Performance Measures

According to industry experts, it is a customary practice for CVB's around the country to provide subsidies and discounts to groups that bring a major event to a City. So our concern here is not that the CVB provided a subsidy to this group. Rather, it is that TSJ paid for rooms at the Hayes mansion and they were included in the total of room nights that were counted toward Team San Jose's accomplishment of its hotel-nights performance target for fiscal year 2010-11. Team San Jose counted these Hayes mansion room nights toward its hotel night performance target, however the CVB actually paid for these rooms through its subsidy to the group.

This transaction also raises a larger issue about whether TSJ should receive credit toward its City performance targets for the other meetings and groups that it subsidizes each year. Currently, when a meeting group receives a subsidy, the economic impacts this subsidized group brings to San José is fully counted toward Team San Jose's results against its performance targets.

In FY 2010-11, Team San Jose provided about \$135,000 in subsidies. In addition, San Jose Hotels, Inc. (which is an outside organization controlled by local hotels), provided about \$400,000 in additional subsidies. This is not an unreasonable amount of subsidy, but to ensure the Team San Jose performance measure truly reflects outside dollars that are brought to San José, we recommend in the future, to ensure proper credit to Team San Jose for the economic impact that its activities generate for the City and its hotels, it should evaluate how other CVBs across the country incorporate the value of subsidies in their calculation of economic impact.

Last year, in our performance audit for FY 2009-10, we stated that public funding of subsidies and sponsorships from related-party organizations should not be included in the calculation of performance measures such as gross revenues. Similarly, this year we believe that all City-funded monetary and non-monetary subsidies (i.e. hotel room nights) should not be included in any of the performance targets stated in the Management Agreement. The focus of the

performance measure calculations is on new revenue and true economic impact. City-funded subsidies and other tax-based subsidies (i.e. HBID) are not 'new' revenue. In our opinion, including such funds would be counter to the intent of the performance measures as stated in the Management Agreement.

Recommendation #4: In the future, to ensure that Team San Jose receives proper credit for the economic impact that its activities generate for the City and its hotels, the City and Team San Jose should evaluate how other CVBs across the country incorporate the value of subsidies in their calculation of economic impact.

Team San Jose Corporate Travel and Entertainment Policy

As part of its effort to attract visitors to San José, Team San Jose's sales team frequently travels to other cities throughout the country to call on potential customers. In FY 2010-11, Team San Jose spent \$138,000 for such travel, which seems a modest amount given the national focus of Team San Jose's sales effort. And since CVB's agreement with the City directs that the CVB not spend imprudently or in a manner that could be considered an inappropriate use of public funds, the CVB has established a travel and entertainment policy that outlines reasonable guidelines for reimbursing travel and entertainment expenses.

Under its travel and entertainment policy, Team San Jose will reimburse employees travelling on company business for documented expenses including transportation, lodging, meals, and other expenses needed to conduct business. For example, staff required to take a commercial flight while traveling on TSJ business almost always fly coach or economy class. Similarly, the TSJ travel policy sets a reasonable dollar limit on what TSJ will reimburse the traveler for hotel stays, and for the cost of ground transportation. TSJ also reimburses its sales staff for reasonable entertainment expenses, such as hosting customers or potential customers to restaurant dinners as long as the spending is part of conversation about the client holding a major event or meeting in San Jose.

To ensure that TSJ is adhering to its own travel and entertainment policy, we reviewed two FY 2010-11 travel and entertainment expenditures -- a sales manager's travel expense claim and an invoice that covered airline expenses for one month in FY 2010-11. Both the travel expense claim and the airlines invoice were well documented and properly approved by a supervisor and we did not identify any instances in which TSJ did not adhere to its travel policy. Also, the sales manager's travel expense claim showed that he was reimbursed for several entertainment expenses in addition to his travel expenses. According to Team San Jose, the cost of entertainment expense must be weighed against the economic benefits that such expenses generate for the City and its hotels. We

confirmed this view by interviewing a consultant to destination management organizations (such as our CVB) throughout the country, who told us that such entertainment expenses are customary in the convention and visitor industry.

As a result, we believe that TSJ has an industry-appropriate travel and entertainment policy in place. However, if the City Council or City Administration have any concerns about downstream uses of TOT or other City-generated funds, it should address those concerns to TSJ.

Conclusion

In FY 2010-11, Team San Jose dramatically improved its financial performance, and met 7 of 9 performance targets. In so doing, it achieved the maximum performance incentive fee.

RECOMMENDATIONS

Recommendation #1: To ensure consistency from year to year in how the TSJ computes its gross operating profit, we recommend that the City and TSJ work together on clarifying the conflicting language in the management agreement.

Recommendation #2: To make its reporting of its results more meaningful to readers, we recommend that Team San Jose reformat its monthly report so that CVB's accomplishments for the month covered are shown next to the Team San Jose's performance targets.

Recommendation #3: In recognition of the shared strategic direction of the convention and cultural facilities and the CVB, we recommend that the City consolidate the two operating agreements with the Team San Jose and the CVB into one agreement. The best time to consolidate the two agreements will be June 2014, when both agreements expire. We recommend that the City adopt a single agreement that covers both the convention and cultural facilities and the CVB and that establishes one set of performance measures for Team San Jose. Also, a new single agreement should eliminate the requirement for a separate set of accounts and separate financial audits for each of the two organizations.

Recommendation #4: In the future, to ensure that Team San Jose receives proper credit for the economic impact that its activities generate for the City and its hotels, the City and Team San Jose should evaluate how other CVBs across the country incorporate the value of subsidies in their calculation of economic impact.

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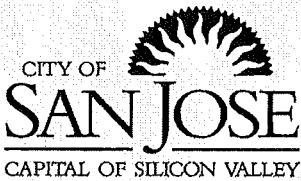
APPENDIX A

Methodology for Calculating the Performance and Incentive Measures

Measures	Type of Measure	Basis for Calculations
Gross Operating Profit/Revenue		
Gross Operating Revenue	Incentive only	<p>Those revenues from operation of the Facilities excluding revenue billed by TSJ on behalf of other vendors providing services to clients of the Facilities.</p> <p>In calculating gross operating revenue, and per Recommendation # 4 in the FY 2009-10 performance audit of TSJ, we have excluded \$24,000 in revenue reimbursements for services TSJ provided to the City's Hotel Business Improvement District and \$20,073 expensed by CVB to sponsor events.</p>
Gross Operating Profit	Performance only	<p>Revenues (as described above) minus direct and indirect expenses related to the operation of the Facilities. Per the agreement, we did not include the following expenditures in calculating gross operating profit: the executive management fee, depreciation expense, City contract oversight costs, fire insurance, City funded repairs and maintenance, or the City's free use of the Convention Center.</p> <p>As noted above, TSJ reported a more favorable net loss than the net loss that we calculated in Exhibit 4, pg.16. TSJ calculated a net loss of \$1.8 million, whereas we calculated a net loss of \$2.4 million.</p> <p>Because section 4.8 of the Management Agreement regarding calculation of GOP was silent on the treatment of management fees, TSJ's Chief Financial Officer (CFO) sought guidance from City staff who told the CFO to exclude the <i>fixed minimum management fee</i> (\$150,000) and the <i>incentive fee</i> (\$350,000) from the calculation of the gross operating loss. As shown in Exhibit 4, there are three components of the management fee: (1) the \$150,000 fixed minimum management fee specified in section 7.2 of the Management Agreement, (2) the \$350,000 incentive fee specified in section 7.3, and (3) the \$600,000 executive management fee specified in section 7.1.</p> <p>Section 7.1 clearly states that "<i>the Fixed Executive management fee shall not be considered an operating expense and therefore, will be charged below the gross operating profit line of the income statement. Any additional expenses associated with Executive Compensation shall be considered an Operating Expense and will be charged above the Gross Operating Profit line of the Income Statement.</i>" Our calculation follows section 7.1 of the Agreement and includes the <i>fixed minimum management fee</i> and the <i>incentive fee</i> as expenses above the line in the GOP calculation. So, the discrepancy is largely the result where we followed the guidance in one paragraph and TSJ (with City staff approval) followed the guidance in the other paragraph.</p>
Economic Impact		
Hotel Nights	Performance, Incentive	Measured as the total number of hotel room nights booked by the CVB over the course of the Fiscal Year and the total number of hotel room nights booked that can be directly or indirectly attributed to activities at the Facilities.
Event Attendance	Performance, Incentive	Number of local/social visitors, out of town visitors, and exhibitors.

Measures	Type of Measure	Basis for Calculations
Estimated Impact	Performance, Incentive	Average daily spending rates multiplied by event attendance. Average daily spending rates may vary depending on if the attendees are local/social visitors, out of town visitors, and exhibitors. This methodology was mutually agreed upon by the City and the operator as a means to estimate consumer spending related to events.
Return On Investment	Performance only	<p>The Management Agreement and addendum outline that the measure of the City's return on investment is based on the following formula:</p> $\frac{[\text{gross revenues from the operation of the Facilities}] + [\text{estimated economic impact}]}{[\text{direct and indirect expenses paid for the operation of the Facilities}] + [\text{Facilities debt service}]}$
Theater Attendance		
Performance Days	Performance, Incentive	All days that the City and the operator mutually agree are both available and suitable for performance of a scheduled performance or event. Performance days are measured by the extent to which TSJ maintains or increases use of the theaters on performance days.
Occupied Days	Performance, Incentive	Days that a theater is utilized under contract and not available for booking for other events.
Customer Satisfaction		
Satisfaction Rate	Performance, Incentive	The results of the operator's surveys that ask the event coordinators to rate their overall satisfaction with the product and services provided. Satisfactory is considered "excellent," "very good," or "good."

Source: Auditor summary of terms outlined in the Addendum and Second Amendment to the Management Agreement.



Memorandum

TO: Sharon Erickson
City Auditor

FROM: Kim Walesh
Bill Sherry

**SUBJECT: RESPONSE TO ANNUAL
PERFORMANCE AUDIT OF
TEAM SAN JOSE'S MANAGEMENT**

DATE: January 17, 2012

Approved

Date

1/18/12

EXECUTIVE SUMMARY

This memorandum is a combined response between the City Administration and Team San Jose, in response to the City Auditor's FY 2010-2011 Performance Audit of Team San Jose and the San Jose Convention and Visitors Bureau.

We appreciate the hard work, efforts and comments made by the City Auditor in the completion of the audit. The comments below address the recommendations and related opportunities suggested in the report.

The City has two contracts with Team San Jose: one for the management of the Convention Center and six Cultural Facilities (management agreement) and another for services provided as the San Jose Convention and Visitors Bureau (CVB agreement).

This is the first year that the City Auditor has evaluated the San Jose CVB performance and the information included in their report is helpful in guiding additional questions and work to the City's Tourism Industry Advisor, Conventions, Sports & Leisure (CSL), Inc, hired last year to assist the City Administration with additional expertise about convention business trends.

TSJ has made a tremendous amount of effective changes over the last 10 months, including streamlined Board functions and Board engagement, new CEO leadership and increased transparency and communication with City counterparts.

Fiscal Year 2010-2011 performance results, coupled with constructive corporate changes, created the necessary refocus and efficiencies for the City to reverse their decision on moving forward with a process to develop an RFP.

In addition, of the 13 audit recommendations from last year's performance audit, the City and Team San Jose have implemented all recommendations.

For the current audit, City Administration and Team San Jose agree with all audit recommendations.

January 17, 2012

Subject: Response to Team San Jose Annual Performance Audit

Page 2

**CITY AUDIT RECOMMENDATIONS AND COMBINED CITY
ADMINISTRATION/TEAM SAN JOSE RESPONSE**

City Audit Recommendation 1: To ensure consistency from year to year in how TSJ computes its gross operating profit, we recommend that the City and TSJ work together on clarifying the conflicting language in the management agreement.

Combined Response to Recommendation 1: The City Administration and Team San Jose agree to this recommendation and will return to the City Council with a revision to the Management Agreement in February to further clarify the GOP calculation in the coming months.

Further, at that time, the City will be recommending a revision to the GOP calculation. This recommendation will consist of the inclusion of Transient Occupancy Tax and parking garage net profits. The goal behind this change is to create a sustainable enterprise fund for the convention center and theater operations, similar to the Airport. The restructured calculation for Gross Operating Profit demonstrates the City's ongoing commitment through TOT revenue to support the local economic benefit of the Convention Center and Theaters, and ensures that no General Fund resources are required to support operations. Under this new calculation, the measure of success for Team San Jose's Gross Operating Profit would shift from a negative to a positive number, reflective of the positive contributions made by Team San Jose to the local economy. Exhibit A below includes an example of how the City may calculate Gross Operating Profit/Loss.

Current Alignment regarding GOP calculation between City and TSJ:

Currently, there is alignment as to how GOP is calculated, even though as the City Auditor states; there is inconsistency in the Management Agreement. Until there is a revision to the Management Agreement to clarify the GOP calculation, the City and TSJ agree to use section 4.8 of the Agreement as the GOP calculation. This decision was made in early 2011 between both parties; but the City and TSJ will revise performance targets in light of restructured financials.

SHARON ERICKSON, City Auditor

January 17, 2012

Subject: Response to Team San Jose Annual Performance Audit

Page 3

Exhibit A: New TSJ Restructured Financials

	FY 2011-2012	
	<u>Current</u>	<u>Proposed</u>
TOT Revenue Transfer		\$ 5,440,865
Net Parking Revenue		800,000
Operating Revenue	12,132,548	12,132,548
City Free Use	(50,000)	(50,000)
Total Operating	(16,019,059)	(16,019,059)
City W/C	(300,000)	(300,000)
City Overhead	(358,964)	(358,964)
Fixed Mgmt Fee		(150,000)
Executive Mgmt Fee		(600,000)
Insurance		(98,000)
<i>Gross Operating Profit < Loss ></i>	<u>(4,595,475)</u>	<u>797,390</u>
TOT Transfer	5,440,865	
Fixed Mgmt Fee	(150,000)	
Executive Mgmt Fee	(600,000)	
Incentive Fee	(200,000)	(200,000)
Insurance	(98,000)	
Net Parking Revenue to Parking Fund		(800,000)
Industry Advisor	(100,000)	(100,000)
Misc Improvements	(500,000)	(500,000)
Civic Improvements	(450,000)	(450,000)
Oversight Overhead	<u>(400,000)</u>	<u>(400,000)</u>
Net Income <Loss>	(1,652,610)	(1,652,610)

January 17, 2012

Subject: Response to Team San Jose Annual Performance Audit

Page 4

City Audit Recommendation 2: To make its reporting of its results more meaningful to readers, we recommend that Team San Jose reformat its monthly report so that CVB's accomplishments for the month covered are shown next to the Team San Jose's performance targets.

Combined Response to Recommendation 2: The City Administration and Team San Jose agree to this recommendation and will develop and implement new reporting of CVB accomplishments with TSJ performance goals monthly as part of the FY 2012-2013 reporting schedule.

City Audit Recommendation 3: In recognition of the shared strategic direction of the Convention and Cultural Facilities and the CVB, we recommend that the City consolidate the two operating agreements with the Team San Jose and the CVB into one agreement. The best time to consolidate the two agreements will be June 2014, when both agreements expire. We recommend that the City adopt a single agreement that covers both the Convention and Cultural Facilities and the CVB and that establishes one set of performance measures for the Team San Jose. Also, a new single agreement should eliminate the requirement for a separate set of accounts and separate financial audits for each of the two organizations.

Combined Response to Recommendation 3: The City Administration and Team San Jose agree to this recommendation and will bring forward a consolidation of the two agreements in 2014 when both agreements expire.

City Audit Recommendation 4: In the future, to ensure that Team San Jose receives proper credit for the economic impact that its activities generate for the City and its hotels, the City and Team San Jose should evaluate how other CVBs across the country incorporate the value of subsidies in their calculation of economic impact.

Combined Response to Recommendation 4: The City Administration and Team San Jose agree with this recommendation. It is Team San Jose's desire to stay consistent with practices within the industry so that there are accurate comparisons when compared to competitors and destinations. The City agrees with this approach and will be working with the City's hospitality industry advisor, CSL, to clarify the Economic Impact calculations.

Update Regarding Fund Balance:

The City Administration and Team San Jose agree that a balanced budget is necessary to ensure a healthy fund balance. The City Budget policy has been to build up Fund 536 unrestricted funds in years of economic growth so that in years of economic decline there is funding available to sustain Convention Center and theater operations.

In addition, as a second protection to the fund, a reserve for economic uncertainty and a reserve for capital needs were established last year, based on City Audit direction.

January 17, 2012

Subject: Response to Team San Jose Annual Performance Audit

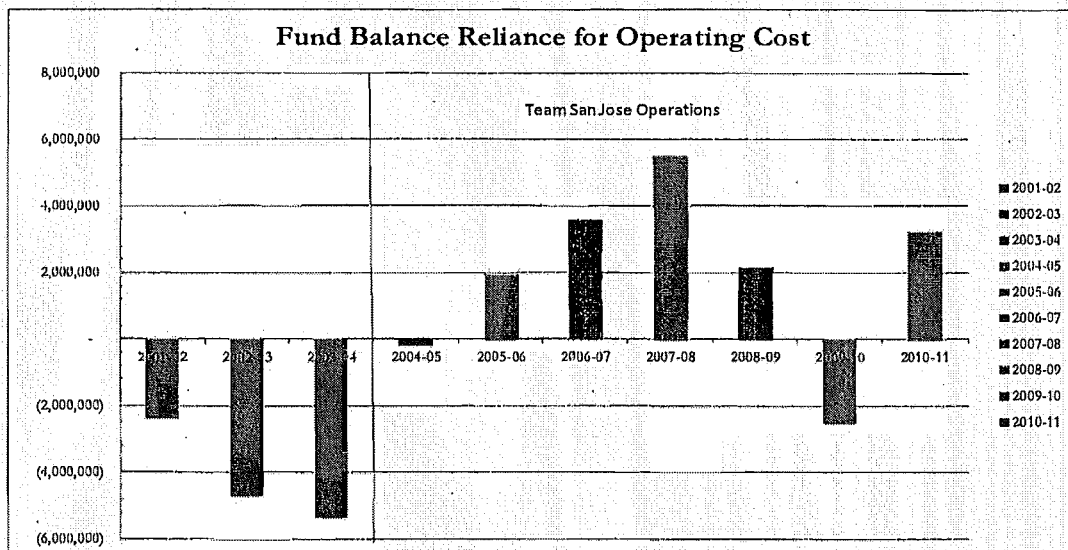
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Team San Jose has historically worked within the TOT revenue transfer, parking revenue and their own operating revenue to cover operational expenses with the exception of years where the use of the unrestricted fund balance was required as a part of the economic downturn cycles. Exhibit B below demonstrates that in most years, the fund balance has grown rather than depleted as a result of successful operations, increase in Parking revenue and strong TOT revenue trends.

In addition, historically the Redevelopment Agency has borne the sole responsibility of funding capital improvements within the Convention Center and the Theaters managed by Team San Jose. Moving forward, however, this responsibility will be solely Fund 536 responsibility.

The City Administration and Team San Jose will continue to monitor the long term health of Fund 536. Areas that limit the fund growth are the removal of the General Purpose Parking transfer as well as increased capital expenditure needs as the facilities get older and need additional capital investment.

Exhibit B: Fund Balance Reliance for Operating Costs




KIM WALESH

Director of Economic Development
Chief Strategist


BILL SHERRY

CEO, Team San Jose

For questions please contact Lee Wilcox, Downtown Manager, at (408) 535-8172, or Meghan Horrigan, Director of Communications for Team San Jose at (408) 792-4175.